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17 January 1983

MEMORANDUM FOR: See Distribution

SUBJECT : Meetings

Type of Meeting : SIG-IEP

Date : Thursday, 20 January 1983

Time : 1100-1200 hours

Place : Roosevelt Room

Chaired By : Secretary Regan

Principal Only? : Plus One

Subject/Agenda : (1) Status of Kuwait under mineral land leasing act.
(2) Foreign investments in the U.S.
(3) LDC debt issues
(4) Report on G-10 Meeting

When to Expect Papers : Tomorrow -- 18 January

Time Info Received : Per Meiko, ES Treasury, 1020

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OFFICE OF THE SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

January 18, 1983

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MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE SECRETARY OF THE INTERIOR
THE SECRETARY OF ENERGY
THE ATTORNEY GENERAL
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

Attached are discussion papers on the Mineral Lands Leasing Act and Foreign Government-Controlled Investments in the United States for the meeting of the SIG-IEP scheduled for Thursday, January 20, at 11:00 a.m., in the Roosevelt Room. Also attached is a paper on Barter Arrangements which has been added as an agenda item. LDC Debt Issues and the G-10 meeting will be the subjects of oral reports and papers will not be provided on these two items.

The minutes of the January 12 SIG-IEP meeting are attached.

David E. Pickford
David E. Pickford
Executive Secretary

Attachments

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January 4, 1983

Status of Kuwait Under the Minerals Lands Leasing Act

Issue: Should Kuwait be found non-reciprocal under Section 1 of the MLLA?

Background: 1) In general, the MLLA covers leasable minerals (oil, gas, coal, sulphur, etc.) located on public and acquired lands. It does not cover offshore oil, which is covered by the OCS Lands Act. Offshore oil and gas represent roughly 70% of the total oil and gas produced on Federal lands. The MLLA does not cover oil and gas produced on State, Indian or private lands.

The MLLA limits the right of foreign citizens to own stock of a domestic U.S. corporation holding leases under the MLLA, if that foreign country denies "similar or like privileges to citizens or corporations of their country."

2) Under the DOI standard of review, foreign citizens may own stock in a domestic corporation owning an interest in U.S. resources if a) U.S. citizens are not precluded or unreasonably restricted from participating in the foreign country's mineral resources because of the U.S. citizen's stock ownership, or if b) stock ownership is prohibited in that foreign country, does the foreign country permit other opportunities for investment or participation in mineral resources on public lands, and if c) that foreign country does restrict investment in mineral resources, is there discrimination against U.S. citizens or corporations.

3) The Constitution of Kuwait decrees that all natural resources are the property of the State. No Kuwaiti citizen owns mineral rights, and all exploration and production for oil is carried out by the Kuwait Petroleum Company (KPC). Foreign participation in commercial activities is permitted by law, through partnerships and joint stock companies provided that 51% of the stock is Kuwaiti owned. Joint ventures are also permitted. Since 1980, all oil and gas activities have been consolidated in KPC, including the acquisition of foreign concessions previously granted to foreign companies, with the exception of a jointly administered Kuwaiti-Saudi concession. There are no companies with Kuwaiti stockholders currently involved in oil and gas activities with KPC. Neither Kuwaiti nor U.S. citizens hold mineral interests, and thus there appears to be no evidence of discrimination against U.S. citizens.

Analysis and Decision: A concession to explore for and develop minerals may be issued by the Government of Kuwait. Furthermore, U.S. citizens may own up to 49% of the stock of a Kuwaiti Corporation, and such corporation could be granted a concession or participate in ventures with KPC. All resource activities in Kuwait are conducted by KPC, and no Kuwaiti citizens may invest in KPC.

In interpreting the MLLA, the Interior Department has focused on the effect of investment by U.S. citizens in foreign corporations. Kuwaiti law does not preclude private or foreign investment, and there is no discrimination against U.S. citizens. Therefore, Kuwait should be found reciprocal under Section 1 of the MLLA.

Comments: 1) DOI received several hundred negative comments on Kuwaiti reciprocity. Most were written on 3 x 5 postcards, postmarked from North Carolina, and were not substantive. Generally, they objected to oil and gas activities on public lands in western North Carolina, particularly by foreigners.

2) In 1982, KPC purchased Santa Fe International for $2.5 billion. At that time, Santa Fe International had a small interest (worth roughly $9 million) in Federal leases. Since that time, they have increased their holdings in Federal leases through the acquisition of a small oil and gas exploration company with Federal and non-Federal leases. Santa Fe has invested much more heavily in offshore leases, with leases valued in excess of $25 million. Santa Fe has expressed an interest in acquiring further leases. If Kuwait were found non-reciprocal, further investment in a depressed industry would be barred, and Santa Fe might be forced to divest itself of all Federal onshore leases.

3) KPC has invested substantial capital above its initial investment in Santa Fe International. Santa Fe has been a leader in developing exploration technology for Alaskan offshore operations, which are capital intensive and require very long term investment.

4) All resources produced in the U.S. can be controlled in emergency situations through the Defense Production Act and other legislation.

 [illegible] e Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

DEC 29 1982

DECISION ON THE STATUS OF KUWAIT UNDER THE MINERAL LEASING ACT OF 1920 (30 U.S.C. § 181 et seq.)

On July 8, 1982, the Department of the Interior requested public comment on the laws, customs and regulations of Kuwait to assist the Department in making a determination on the status of that country under section 1 of the Mineral Leasing Act of 1920, 30 U.S.C. § 181. 47 Fed. Reg. 29720. The comment period was extended by notice published on August 16, 1982. 47 Fed. Reg. 35559. This inquiry will determine the eligibility of citizens of Kuwait to own interests, through stock ownership, stock holding or stock control, in leases and permits issued pursuant to the Mineral Leasing Act of 1920, 30 U.S.C. § 181 et seq. ("the Act"), and the Mineral Leasing Act for Acquired Lands, 30 U.S.C. § 351 et seq. The minerals in question are deposits of oil, gas, coal, sulphur, phosphate, potassium, sodium, oil shale and gilsonite owned by the United States and subject to disposition under the Act as well as oil or gas transportation pipeline rights of way issued under the Act.

I. Section 1 of the Act

Section 1 of the Act authorizes leasing of lands and disposition of identified minerals to citizens of the United States, associations of such citizens, domestic United States corporations and, in certain circumstances, municipalities and other governmental entities. Citizens of foreign countries may invest in leases and permits issued pursuant to the Act only through the stock of domestic United States corporations. Section 1 limits this right of investment in the following manner:

> Citizens of another country, the laws, customs or regulations of which deny similar or like privileges to citizens or corporations of this country, shall not by stock ownership, stock holding, or stock control, own any interest in any lease acquired under the provisions of this Act.

II. Public Comments

In response to the request for public comments, the Department received 391 comments. The vast majority of the commenters did not provide information concerning the laws, customs or regulations of Kuwait. Rather, most were quite brief and expressed general opposition to oil and gas development in certain parts of the country, or to any investment in the domestic oil and gas industry by citizens of Kuwait and other "OPEC" nations, or to both. In short, these comments were conclusory and did not provide factual information that would be helpful in analyzing the laws, customs, and regulations of Kuwait. Several commenters argued that since Kuwait has nationalized its oil industry, it obviously denies similar or like privileges to citizens of this country. There commenters were either unaware of or opposed to this Department's long-standing interpretation and application of section 1 of the Act that nationalization does not by itself render a nation non-reciprocal. These comments also were not helpful in providing information to analyze the status of Kuwait. One commenter provided a detailed analysis of section 1 and Kuwait law. This commenter argued that the legislative history and prior administrative interpretations of section 1 of the Act support the proposition that foreign citizens should not be disqualified unless the foreign country in question imposes unreasonable or discriminatory restrictions on opportunities by United States citizens to invest in the mineral resources of the foreign country. It further argued that in 1919 Congress contemplated leaving oil producing countries free to develop their own oil exploitation policies provided they did not discriminate against the United States. The commenter concluded that citizens of Kuwait should not be disqualified under section 1 of the Act. No comments were received from other government agencies.

In addition to the comments, the Department considered the significant volume of information in Departmental files, including information on Kuwait law provided by the Government of Kuwait through the Department of State.

III. Standard of Review

In his memorandum to the Secretary of February 2, 1982, the Associate Solicitor, Energy and Resources, identified three standards under which the laws, customs and regulations of a foreign country are to be analyzed in determining whether laws, customs and regulations of a foreign country deny similar or like privileges to citizens of the United States. These standards resulted from a review of the statutory language, legislative history and Departmental administration of section 1 of the Act beginning in 1920.

Under the first standard identified by the Associate Solicitor, the Department must find that the foreign country allows stock participation by United States citizens in corporations which, in turn, are not precluded or unreasonably restricted from participating in the foreign country's mineral resources on its public lands because of the United States citizen's stock ownership. If the foreign country prohibits stock ownership, the Department applies the second standard to determine whether the foreign country allows other opportunities for investment or participation in the mineral resources on its public lands. In the event the foreign country restricts investment or participation in its mineral resources to state-owned entities, the Department must, under the third standard, determine whether discrimination exists against citizens or corporations of the United States.

IV. The Laws, Customs and Regulations of Kuwait

The laws, customs and regulations discussed below are those applicable to exploration and development of mineral resources in Kuwait and to stock ownership, stock holding and stock control in that country by citizens and corporations of the United States.

Laws

The 1962 Constitution of the State of Kuwait.

Article 21 of the Constitution decrees that all natural resources and derivative revenues are the property of the State. Article 152 authorizes the granting of concessions for exploitation of natural resources only "by a law and for a limited period." There is no restriction in the Constitution on the ability of aliens to hold or to invest in such concessions.

Law No. 19 of 1973 concerning the Conservation of Petroleum Resources.

This law authorizes the Government of Kuwait to issue regulations governing all aspects of petroleum exploration and development.

Decree Law No. 6 of 1980 establishing the Kuwait Petroleum Corporation.

This law established the Kuwait Petroleum Corporation (KPC), which is wholly owned by the Government of Kuwait. KPC, through a subsidiary, owns the sole outstanding concession for the exploration and development of hydrocarbon substances found in Kuwait, except for one concession in the offshore area jointly administered by Kuwait and Saudi Arabia. KPC is chartered to engage in all phases of the hydrocarbon industry, including exploration, development and transportation (Article 3). KPC is authorized in carrying out these purposes to participate with other companies and to establish companies in partnership with others (Article 5). Decree Law No. 6 assigned the Government-owned shares of various companies involved in hydrocarbon activities in Kuwait to KPC (Article 8).

Law No. 15 of 1960 (of Commercial Companies)

This law allows foreign participation in commercial activities within the country of Kuwait through partnerships and joint stock companies, provided that 51% of the capital holdings is owned by Kuwaiti citizens. This law also authorizes the formation of joint ventures with no limitation on citizenship. This law is the only expression of Kuwait policy with regard to foreign investment brought to the attention of the Department. The Department understands that outside the scope of Law No. 15, a foreign corporation may directly engage in commercial activities in Kuwait, although in some circumstances the foreign corporation must employ a Kuwaiti agent.

Customs and Regulations

The prevailing custom in Kuwait has been to consolidate all oil and gas activity under the ownership of the Government and, since 1980, in the Kuwait Petroleum Corporation (KPC). This consolidation included the acquisition by the Government of concession rights previously granted to foreign companies and their subsequent assignment to KPC. One foreign-owned company continues to operate offshore in the area under the joint administration of Kuwait and Saudi Arabia. KPC has not exercised its authority to engage in joint operations with foreign companies nor has the Government of Kuwait issued any new concessions to foreign companies. Similarly, no companies with Kuwaiti stockholders are currently involved in oil and gas activities with KPC or through new concessions. However, there is no evidence that any custom or regulation discriminates against investment by United States citizens.

V. Analysis

From our understanding of the laws, customs and regulations of Kuwait, a concession to explore for and develop mineral resources may be issued by the Government of Kuwait. These concessions would be issued to an entity organized under Law No. 15 or to foreign entities. In some instances, foreign entities are required to conduct business in Kuwait through

Kuwaiti agents. Other than in the offshore joint administration area, the only entity currently authorized to conduct oil and gas activities is the Kuwait Petroleum Corporation (KPC), which is a state-owned company. KPC is authorized by law to join with others to conduct these activities, presumably with or through an entity organized under Law No. 15 or with a foreign entity authorized to do business directly in Kuwait. At present, KPC has not engaged in any joint participation projects.

Under Law No. 15, United States citizens may own up to 49% of the stock in a Kuwaiti corporation. Kuwaiti law contains no limitation or restriction on the activities of a corporation which has stockholders who are citizens of the United States. Such corporations may, if the opportunity is presented, participate independently or with the Kuwait Petroleum Corporation (KPC) in any phase of the hydrocarbon industry. Similarly, United States citizens may engage in joint ventures independently or with KPC, if the opportunity is presented. The 49% limitation is not an unduly harsh or restrictive limitation on stock or partnership capital ownership. While this requirement may alter the opportunity for economic return to the United States stockholder, and thus be a factor in the investment decision, it does not render the stock participation illusory or meaningless. This limitation is similar to the Canadian law which the Secretary found does not deny similar or like privileges under section 1 of the Act in his decision of February 2, 1982, concerning the reciprocity status of Canada.

Finally, no discrimination exists under the law of Kuwait against citizens of the United States. KPC is wholly-owned by the Government of Kuwait. No Kuwaiti citizens may invest in KPC because the law of Kuwait does not allow such investment. Moreover, we have no evidence that KPC has engaged in any joint participation activities with companies owned by Kuwaiti citizens to the exclusion of companies owned in whole or in part by citizens of the United States. Thus, the laws, customs and regulations of Kuwait are applicable to all private investment in mineral resources, whether that investment is by citizens of Kuwait, by citizens of the United States, or by citizens of any other country.

The Department received no comments or information concerning the laws, customs or regulations of Kuwait with regard to minerals other than oil and gas which differ from those applicable to oil and gas.

The restriction on foreign ownership of interests in federal onshore mineral leases and permits had two purposes. First, it was designed to avoid foreign retaliation against, and to discourage foreign discrimination against, investments in minerals by citizens and corporations of the United States. H.R. Rep. No. 398, 66th Cong., 1st Sess., p. 11 (1919). Second, it was intended to prevent adverse impacts from uncontrolled and unchecked exportation of domestic mineral resources. Id. The Act itself was intended to "promote the mining of coal, phosphate, oil, oil shale, gas, and sodium on the public domain." 41 Stat. 437. In section 32 of the Act, 30 U.S.C. § 189, Congress empowered the Secretary "to prescribe necessary and proper rules and regulations and to do any and all things necessary to carry out and accomplish the purposes of this Act."

From the earliest time, the Department has focused on the issue of the effect of investment by United States citizens in foreign corporations on the ability of that corporation to participate in the mineral resources of the foreign country. E.g., letter from Secretary of the Interior to Secretary of State dated October 19, 1920. This emphasis on discrimination, which originally arose in the Congressional debate on section 1 (discussion among Congressmen Snell, Sinnott and Evans, 58 Cong. Rec. 7528-7529 (1919)), was ratified in a letter from the Deputy Solicitor to the Legal Advisor for Economic and Business Affairs, Department of State, dated August 23, 1974. In this letter, the Deputy Solicitor emphasized that the citizenship of an individual or corporation was irrelevant to investment in the coal resources of Great Britain. After finding that the British government had nationalized the British coal industry and that no private participation, British or foreign, was allowed, the Deputy Solicitor concluded that this did not constitute the discrimination required to disqualify investment by British citizens under section 1 of the Act. The laws, customs, and regulations of Kuwait simply do not prohibit private (and foreign, on an equal basis) investment and participation in mineral resources development, unlike the assumption made in the 1974 letter regarding the law of Great Britain.

VII. Decision

The above analysis demonstrates that the laws, customs and regulations of Kuwait do not discriminate against citizens of the United States. No evidence exists that a company has been denied participation in mineral resources of Kuwait since the adoption of Decree Law No. 6 because citizens of the United States held an interest.

Based on the facts described above, the laws, customs and regulations of Kuwait do not deny similar or like privileges to citizens or corporations of the United States within the meaning of section 1 of the Mineral Leasing Act of 1920, 30 U.S.C. § 181. Therefore citizens and corporations of Kuwait may, through stock ownership, stock holding or stock control in corporations of the United States, own interests in federal mineral leases and permits subject to section 1 of the Act.

Date: 12/22/82

Assistant Secretary--Land and Water Resources

I Concur:

William H Coldiron
SOLICITOR
12/29/82

FOREIGN GOVERNMENT-CONTROLLED INVESTMENTS IN THE UNITED STATES

The United States has been more open and receptive to foreign investment than other countries. It appears we are the only government that does not have the legal authority to reject an investment on general national interest grounds. We have maintained this policy because foreign investment, like domestic investment, substantially benefits the U.S. economy. There is concern, however, that investments in the United States, if controlled by foreign governments, may have adverse effects.

There are very few data available on the operations in the United States of firms controlled by foreign governments. There is, however, a growing tendency for governments to intervene aggressively in markets to resolve international trade and investment problems that are perceived to threaten their national economic, social or political goals (e.g. increased employment, reduction of balance of payments deficits, or sectoral development). There is concern is that such interventions, particularly by certain governments who have a non-market philosophy, could influence the operations of foreign government-controlled subsidiaries in the United States to a degree sufficient to distort market performance here.

One factor that may create difficulties in responding to this problem is defining what constitutes government ownership. One possible approach is to adopt a definition based on percent of voting shares. This is not an ideal solution, however, since the nature of government control will vary from case to case independent of formal voting power and may depend on the attitude of the government with control.

Government Intervention

Government intervention in the market takes a number of forms. Some of the more common forms include:

-- protectionist measures;

-- buy national or discriminatory government procurement policies;

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-- subsidies to declining or inefficient industries;

-- tax concessions on export earnings;

-- subsidized export credit financing;

-- counter-trade, buyback, and offset agreements; and

-- performance requirements on foreign, and sometimes domestic investors.

It is apparent that governments, including the United States Government, have intervened in the market and will continue to intervene in response to political or economic pressures. Pressures for government intervention of this type can be expected to be greater and more likely, however, where a government has a vested equity interest in the operations of an entity. The performance of a government-owned entity and the implications of its operation for the home markets are likely to be more closely scrutinized than its private-sector counterpart. Political and economic pressures are also more likely to be applied to a government-owned entity than to a private entity to ensure that the government-owned entity conforms to the policies and goals of the government.

Ownership also permits the government to control these entities more easily than private enterprises, and to implement government policy through the management of entity operations without any public announcement or detection. Decisions, made allegedly for commercial reasons, do not have to be debated publicly and usually are not subject to legal review, as are government regulations. In instances where the government is the sole buyer (e.g., in many cases in telecommunications) and it owns the seller there could be great pressures for it to buy from the controlled seller.

Reciprocity

Adoption of reciprocal measures by the United States Government has been suggested as a potential policy response to foreign government intervention in trade and investment. Reciprocity in general, however, is not an effective response to foreign investment restrictions. Governments generally restrict incoming foreign investment for nationalistic purposes, e.g., to ensure domestic control over industry. Governments often favor retaining capital in their own country and may restrict their citizens ability to make outgoing foreign investments abroad in an effort to obtain a short-term foreign exchange benefit and in the belief that such restrictions will translate into increased domestic investment. Hence, restrictions on foreign investment are likely to be welcomed, particularly when imposed by attractive host countries. The Canadian Government, for example, does not have foreign exchange restrictions, but, given the Canadian Government's desire to increase domestic investment, is unlikely to oppose U.S. restrictions on foreign direct investment.

The adoption of a reciprocal policy on foreign investment by the United States is, therefore, unlikely to lead to any modification of the restrictive foreign investment policies of most countries; but it would result in a reduction of foreign direct investment in the United States and its associated benefits.

Where foreign governments discriminate against U.S. investment, the U.S., nevertheless, might be able to exert pressure on foreign governments by imposing selective restrictions against foreign governmental investment. The extent of the leverage would depend, however, on the relative importance of an investment in the U.S. compared to other investment opportunities.

Inter-Agency Working Group on International Investment Policy Assessment

An inter-agency working group reviewed potential problems associated with foreign governmental direct investments in the United States, and it has determined that existing U.S. mechanisms may suffer from a number of shortcomings in addressing potential problems which may arise in this area. These shortcomings include a lack of adequate information and the inappropriateness of existing laws and remedies. U.S. laws were not designed to respond to peculiar problems raised by foreign governments ownership.

The only broad legal powers that the United States Government presently possesses are contained in the International Economic Emergency Powers Act (IEEPA). The IEEPA, which was enacted in 1977, can be triggered only by the declaration of a national emergency by the President, and its reputation as an asset-blocking statute makes foreign investors, particularly depositors, very nervous. Hence, it would be practically impossible to invoke this statute in response to a specific, discrete investment. It has been invoked only during the Iranian hostage crisis, and even in that situation questions were raised concerning the appropriateness of its use. It is, therefore, not a power that the United States should rely on to respond to foreign direct investments damaging to U.S. national interests.

The Committee on Foreign Investment in the United States (CFIUS) reviews foreign governments' direct investments in the United States but it must rely on voluntary notification of such investments. While investments involving acquisitions of large publicly-traded companies are likely to come to the Committee's attention, even if the Committee is not formally notified by the foreign government, a number of investments by government-controlled firms have occurred and have not come contemporaneously to the Committee's knowledge.

The Committee currently has no legal authority to require that a foreign government delay or modify an investment in the United States. In addition, there is no systematic collection of information presently available to the Committee on the acquisition or operation of foreign government-controlled firms in the United States.

The Inter-Agency Working Group on International Investment Policy has been reviewing this issue for some time, and three possible views have surfaced:

1. There is no evidence that there are real problems associated with foreign government-controlled investments in the United States or that existing laws are not adequate to deal with foreseeable problems. The U.S. Government should take no further action until additional evidence establishes that the United States is being harmed by such investments.

2. There may be real problems associated with foreign government-controlled investments and current U.S. laws may not be adequate. However, it would be preferable not to take action at this time.

3. There may be real problems associated with foreign governmental direct investments in the United States and the U.S. Government should examine the possibility of seeking legislation to require mandatory advance notification of foreign governmental investments and

authorizing the CFIUS to monitor the operations of established U.S. subsidiaries of foreign government-controlled firms.

If the United States Government were to require notification in advance of foreign governmental direct investments it would need to consider what types of penalities would be imposed for non-compliance, whether the responsible agency would have the power to subpoena information necessary to complete a review of the investment and whether specific delay requirements would be provided between the time of notification and/or filing of information and the completion of the transaction.

If the United States decided to monitor the operation of existing foreign governmental entities in the United States it could expand existing U.S. reporting systems. Currently, the Bureau of Economic Analysis (BEA) and the Securities and Exchange Commission have reporting requirements. BEA collects parent-subsidiary financial information for use in the U.S. Balance of Payments statistics, but provides data only in aggregated form. The Securities and Exchange Commission collects and makes public detailed financial and operating data on publicly-traded U.S. corporations; however, privately-held firms may fall outside of the SEC reporting requirements. Also the questions posed may be aimed at abuses by private, not public owners. The United States could extend and expand the BEA or SEC requirements or alternatively, a new reporting system could be developed.

Swapping CCC Butter for Soviet Strategic Materials

Issue: The USSR is in the market for as much as 100,000 tons of butter. To compete with current EC offers of subsidized butter, USDA has proposed that the Commodity Credit Corporation (CCC) and GSA barter CCC-owned butter at world market prices for Soviet strategic materials for the U.S. national stockpile. The barter might be linked to Soviet purchases of U.S. grain. It could be carried out either through a government-to-government barter arrangement or through U.S. barter contractors. (Specific USDA proposal attached.)

The SIG should consider whether the USG should barter butter for Soviet strategic materials, either directly or through third parties, and prepare the issue for Presidential decision.

Advantages:

- -- Would reduce CCC butter inventory (currently 185,000 tons and growing), reducing program costs.
- -- Would swap a perishable commodity for strategic materials for the national stockpile for which we are below target, without incurring a budgetary cost.
- -- Would compete with the EC for the Soviet market, countering EC export subsidies and increasing pressures for reform of the EC's general export subsidy program.
- -- If linked to commercial grain sales, would substantially increase potential U.S. grain exports to the USSR, in competition with subsidized EC grain exports.
- -- Wouldn't be a major advantage to the USSR, since the USSR would otherwise buy butter at similar prices from other sources.

Disadvantages:

- -- Would make it more difficult to oppose the wider use of countertrade which has often worked to the detriment of U.S. firms doing business in the USSR and elsewhere.
- -- Would be subsidized sale to the USSR, inconsistent with our Soviet policy, with our objectives vis-a-vis our Allies, and with our trade policy. Would also save the USSR foreign exchange it would otherwise use to purchase butter from other sources.

-- Would send the wrong signal to both the USSR and our Allies at a sensitive time in our relations with them. Other exporters of butter (the EC and New Zealand) and of the strategic materials we acquire from the Soviets could be upset.

-- Could reduce domestic pressures to reform the dairy support program, if CCC stocks are reduced and put to good use.

-- Potential strong criticism from U.S. consumers, who pay higher prices for U.S. butter than would the Soviets, and from interested U.S. companies, if not given the opportunity to participate in the barter deal.

Discussion

The proposed barter of agricultural commodities such as butter for strategic materials from the Soviet Union has important implications for U.S. international trade and foreign policies, as well as our domestic agricultural and budget situations and U.S. objectives for the national stockpile.

The proposal appears to meet CCC requirements for bartering CCC-owned commodities and to be consistent with the President's directive to restructure the strategic stockpile, which encourages the use of barter. CCC statutes specify a number of conditions for barter transactions: CCC must own the commodities; the barter must be bilateral; the bartered commodities must not displace cash sales and must not unduly disrupt world market prices; the U.S. must be a net importer of the material acquired, which must be foreign-produced; the acquired material must be less subject to deterioration and cheaper to store than the counterpart agricultural commodity; and CCC must use private channels of trade. During the 1950s and 1960s, CCC bartered approximately $1.6 billion in agricultural commodities for strategic materials.

The price received for the butter would approximate world market prices, but would be well below CCC acquisition costs and the cost of butter to U.S. consumers. The trade would, however, relieve CCC of storage and interest costs and would acquire for the U.S. Government commodities less susceptible to spoilage and of greater strategic interest.

The transaction raises the question of whether U.S. Government barter operations to acquire materials for the strategic stockpile would encourage foreign governments such as the USSR to require barter or countertrade as a prerequisite for U.S. export sales. However, it might serve as needed leverage to substantially increase U.S. grain exports.

EXECUTIVE SUMMARY

The USSR will import up to 225,000 MT of butter in CY1983. Barter of CCC-owned butter for USSR-owned strategic material could be linked to a Soviet agreement to import as much as an additional 6 million tons of U.S. grain (over current estimated imports of 8 million tons of U.S. grain). Two options to implement this butter for strategic materials arrangement are available: (1) a Government-to-government barter arrangement, or (2) use of U.S. barter contractors. Details and implications of this proposal are spelled out in the attached paper.

BARTER ARRANGEMENT WITH THE USSR

BACKGROUND

It is estimated that during CY 1983, the USSR will import up to 225,000 MT of butter. The major suppliers of butter to the USSR have been the EC, Finland, Sweden and New Zealand. The USSR is currently interested in acquiring up to 100,000 MT, and it is expected that the EC will make a strong effort to conclude an arrangement for this amount within the next few weeks. A barter arrangement involving the exchange of CCC-owned butter and USSR strategic materials for the national strategic stockpile would probably place the U.S. in competition with the EC.

PROPOSED STRATEGY FOR LEVERAGING GRAIN TRADE

The barter of CCC-owned butter to the USSR for strategic materials would be of special importance to them and could be linked with a Soviet agreement to purchase a larger quantity of U.S. grain. Such a commitment would probably not be entered into in writing, but would need to be discussed and clearly understood. In the current October/September year, the Soviets are currently projected to import a total of 38 million tons of grain from all origins, including 8 million from the U.S. In agreeing to barter U.S. butter to them, we could ask that this be increased to perhaps as much as 14 MMT.

AUTHORITY

CCC has broad legal authority to barter CCC-owned butter for strategic materials and to hold title to the strategic material until transferred to the stockpile (See attached OGC memo for detailed opinion).

NATIONAL STRATEGIC STOCKPILE

The USSR produces the following strategic materials which are deficit to the stockpile (See attach table for USSR production, exports and imports).

STRATEGIC MATERIAL	STOCKPILE GOAL	STOCKPILE SHORTFALL
COBOLT	85,400,000 Lbs.	41,607,769 Lbs.
NICKEL	200,000 ST	167,790 ST
TITANIUM SPONGE	195,000 SDT	195,000 SDT
PALLADIUM	3,000,000 Tr Oz	1,747,212 Tr Oz
PLATINUM	1,310,000 Tr Oz	870,402 Tr Oz
IRIDIUM	98,000 Tr Oz	81,010 Tr Oz

The materials must meet GSA specifications. GSA would provide a stockpile site and manage the inventory.

From a transportation cost standpoint, it is to CCC's advantage to negotiate for cobolt, palladium and platinum. (See Cargo Preference section).

METHOD OF OPERATION

OPTION 1. GOVERNMENT TO GOVERNMENT BARTER ARRANGEMENT.

-- CCC, in cooperation with GSA, would enter into an agreement with the USSR covering the kind(s) quantity, specification and delivery of the strategic materials.

-- CCC would negotiate the agreement with the USSR covering the quantity, quality and delivery of the butter.

-- CCC would delivery the butter to the USSR FAS U.S. port. Ocean transport to be furnished by USSR. (Cargo preference not applicable)

-- The USSR would deliver the strategic material to CCC C&F U.S. port. Agreement would provide that 50 percent of the material would be shipped on U.S. flag vessels to comply with Cargo Preference Act.

-- CCC would accept title to the materials at U.S. ports and would pay domestic transporation costs of the strategic material from U.S. port to the GSA storage site.

-- GSA would pay the cost of placing the material in the storage site and all subsequent costs of maintaining the inventory.

OPTION 2. USE OF U.S. BARTER CONTRACTORS

-- CCC would issue invitations for U.S. bidder to enter into a barter arrangement with the USSR under which the contractor would deliver CCC-owned butter (from CCC-stocks and newly purchased unsalted butter of 82 percent milkfat) to the USSR and receive for the account of CCC, strategic materials from the USSR.

-- CCC would accept offers on the basis of the most viable proposed arrangement and proposed barter exchange.

-- CCC and GSA would establish a range for the value of the material (delivered USSR port) and CCC would establish a range for the value of the butter delivered FAS U.S. ports. The successful barter contractor would negotiate within these ranges and could only deviate with the approval of CCC and GSA.

-- The barter contractor would furnish a performance bond in favor of CCC for an agreed upon amount. CCC would draw against the performance bond in the event the barter contractor failed to carry out its responsibilities under the agreement with CCC.

-- CCC would deliver the butter to the barter contractor FAS U.S. port. Ocean transportation to be furnished by the USSR (Cargo preference not applicable).

-- The barter contractor would deliver the strategic material to CCC basis C&F U.S. ports. The agreement between CCC and the barter contractor would provide that the barter contractor pay the cost of ocean transportation and related charges, and that 50 percent of the material be shipped on U.S. flag vessels to comply with the Cargo Preference Act.

-- CCC would accept title to the materials at U.S. ports and would pay domestic transportation costs of the materials from U.S. ports to the GSA storage site.

-- GSA would pay the cost of placing the material in the storage site and all subsequent costs of maintaining the inventory.

-- The barter contractor would receive a quantity of the material at U.S. ports as payment for the barter exchange fee, ocean transportation costs and other related costs approved by CCC. The quantity of the material would be based on the barter exchange fee.

Comments

A barter arrangement would have the following advantages:

-- Reduce the inventory of CCC-owned butter and the amount which would otherwise be purchased by CCC under its price support program, thereby reducing program costs.

-- The displacement of EC exports of butter to the USSR.

-- CCC would swap a pershiable commodity for a strategic material needed for the national stockpile which would have a longer storage life. This would probably be looked upon as a favorable arrangement by the majority of the U.S. public.

-- Positive reaction from most dairy farmers and some from U.S. public.

-- Would benefit the U.S. in general by the acquisition of materials needed for the national stockpile.

-- CCC could later receive reimbursement from GSA for some of its program outlay.

-- Purchase unsalted, 82 percent milkfat butter. Projections are that CCC will purchase about 390 million pounds (172,365 MT) of butter in FY83. One hundred thousand metric tons would represent 56 percent of CCC's projected purchases. CCC buys 80 percent of its butter during the period January-June.

Other Considerations

See the attached statement prepared by ASCS of its concern regarding the delivery of unsalted, 82 percent milkfat butter.

RECOMMENDATION ON QUALITY OF BUTTER.

Use a combination of all options to provide the quantity of butter needed. CCC should purchase unsalted 82 percent milkfat butter for delivery January thru June and during the last part of the year should swap CCC-owned butter for unsalted 82 percent milkfat butter. This would prevent heavy purchases by CCC during the off-flush period. The CCC-owned butter would be diverted into the domestic market and would prevent inflated prices during peak use of high milkfat products such as ice cream.

It is believed that by using a combination of the options, CCC could deliver up to 100,000 MT. If only a direct purchase is used, consideration should be given to a maximum of 50,000 MT per year.

Reimbursement to CCC

Currently, GSA does not have funds which could be used to reimburse CCC for the market price of the strategic materials. However, CCC has authority to hold title to the materials. Options available to CCC include:

-- Provide support to GSA to obtain an budget sufficient to reimburse CCC for the materials.

-- Support legislation which would authorize CCC on a one-time arrangement to transfer title of the materials acquired under this arrangement to GSA without reimbursement.

-- Support legislation which would authorize the GSA to sell the materials for the account of CCC.

CARGO PREFERENCE

The Cargo Preference Act would apply to the shipment of the strategic material since the material is being acquired under a government contract.

The Cargo Preference Act would not apply to the shipment of the butter since the value of the butter would be negotiated at world market prices and delivered FAS U.S. ports and the arrangement would not involve any credit arrangements.

PRIOR PROPOSALS

Attached are letters from Philbro-Salomon Inc. and Cometals, Inc. regarding a barter arrangement with the USSR.

PRICES

Butter

World butter price (fresh, unsalted, 82 percent butterfat), f.o.b. Europe....................$2,025/MT ($.92/lb.)

Estimated ocean freight, U.S. east coast to Black Sea port....................................$150/MT ($.07/lb.)1/

F.o.b. U.S. east coast port..................$1,875/MT ($.85/lb.)

Stowage Charges..$33.29/MT ($1.51/cwt)

F.e.s. U.S. east coast port..................$1,840/MT ($.84/lb.)

Strategic Materials

GSA material on prices is attached.

QUALITY OF BUTTER

The inventory of CCC-owned butter is salted with 80 percent milkfat. The USSR is interested in butter that is unsalted and 82 percent milkfat. (See attached detailed study by ASCS).

Options available

-- Negotiate with the USSR to accept butter directly from CCC inventory. USSR preference and usual imports of butter are of unsalted, 82 percent milkfat. The U.S. may be able to negotiated for small quantities of CCC-owned butter.

-- Swap CCC-owned butter with manufacturers for unsalted, 82 percent milkfat butter. This could prevent major price swings in low production months since the CCC-owned butter would go into the domestic market.

1/ Ocean freight rates are estimated. A published conference rate for refrigerated butter is not available according to the Ocean Transportation Division, GSM.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

JAN 1 9 1983

TO: Members of the SIG

FROM: John R. Block

SUBJ: Barter Arrangement to be Discussed at Thursday's SIG

Enclosed please find a set of questions and answers on the proposal to exchange surplus butter with the USSR for strategic materials.

Enclosure

1) Q. How much butter does the Government now own?

A. Current CCC uncommitted stocks of butter stand at a record 176,000 MT compared to 103,000 MT at this time one year ago. Current CCC stocks of butter represent almost 40 percent of the butter consumed annually in the United States. Even with the special give-away of 57,000 MT of butter to needy Americans, uncommitted CCC inventories of butter are projected to reach 250,000 MT by the end of FY 1983. EC stocks are 338,000 tons.

2) Q. Why the urgency to move this butter now?

A. The average age of the butter held in CCC stocks is 18 months. Butter traded in normal commercial channels is generally less than 3 months of age and rarely acceptable when older than 6 months. As stocks continue to grow and the average age of the inventory increases, our options for disposal (and recovery of costs) will decrease. There is still some question as to how well the quality of our butter can stand up after two years of storage. Aside from the quality aspects of old butter, it is costing the U.S. taxpayer $67 million a year for interest and storage charges on our current inventory of CCC butter. Further, this opportunity will be lost if the EC makes the sale. The EC has recently offered subsidized butter to the USSR.

3) Q. What are the alternatives?

A. Normal channels for domestic utilization of our CCC butter stocks, i.e., school lunch and military feeding programs, are being utilized to the maximum. In addition, we are moving as much butter as we can

(125 million pounds) through state organizations for free distribution to needy Americans. Despite these programs, CCC butter stocks are continuing to grow. The only alternative to significantly reduce the current surplus of butter is to move some of it into export markets. A barter arrangement with the USSR could provide us with much needed strategic materials for which we would be exchanging not hard currency but a deteriorating and costly commodity in surplus.

4) Q. How will the U.S. public react to a barter arrangement with the USSR?

A. This will in part depend on how the arrangement is presented to the public. In effect we will be trading a deteriorating (and costly to store) American surplus product for much needed strategic materials for which we would otherwise be paying hard-earned American tax dollars. The exchange would be made at prevailing world market prices for both the butter and the strategic materials so that there can be no criticism that one side is getting the advantage.

5) Q. Is there a shortage of nickel?

A. No. On the contrary, there is a worldwide surplus and prices are depressed. Although today's price of about $1.75 per pound is up from an early December 1982 price of about $1.45, the price nine months ago was $2.50 per pound. Most producers need about $3.00 per pound to break even on nickel.

6) Q. Why is nickel depressed?

A. For one thing, it is heavily used in the steel industry, which is suffering severe economic difficulties.

7) Q. Is the United States "bailing out" the Soviets, then, by taking nickel off their hands?

A. They have a surplus of nickel and need butter. We have a surplus of butter which will spoil if we don't move it and our grain exports are declining. Perhaps it could be better agreed that the USSR would be "bailing out" the United States in this kind of barter. The United States has been buying nickel from the USSR in recent years on a regular basis for cash.

8) Q. Why barter? Why not just sell it directly?

A. Some believe that a direct sale for cash to the USSR at world market prices (well below U.S. domestic prices) would bring a much stronger negative reaction from American consumers.

9) Q. What will it do to New Zealand?

A. The New Zealand Dairy Board has urged us informally several times to move our butter into the USSR if we have to move it, since this would minimize the impact on regular world butter trade.

10) Q. Wouldn't this be a subsidized sale, and aren't we opposed to subsidizing sales, especially to the USSR?

A. It could be asked whether the sale is subsidized or whether it was the purchase (at our U.S. support price) which was subsidized.

In any case, it would reflect the world market price. The subsidy actually has already been paid to the U.S. dairy producers. The Soviets would never pay, nor have they ever paid, more than the world price. That is far below the European or U.S. dairy support price.

11) Q. Aren't we opposed to the use of barter (counter-trade) in principle?

A. No. It does not seem logical to have a policy of opposition to barter. Each barter contract must stand upon its own feet, but no blanket policy of disapproval should be taken.

12) Q. Will a barter of 100,000 tons of U.S. butter fill the USSR butter need?

A. Yes, for at least many months, perhaps a year or more.

13) Q. How will such a butter sale be viewed by Congress?

A. A sale of this magnitude at this time could be expected to receive a positive response from Congress. Language calling for a sale of surplus dairy products from CCC was included in the report on the FY 83 Agricultural Appropriations Bill, H.R. 7072. While some Congressmen and Senators can be expected to respond negatively to anything we do, doing nothing with our dairy surplus will eventually create some real negatives, especially if we have to start throwing it away. As a strategy to close the EC off from that market, it will be viewed very positively.